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TAGS: EFIN ECON ETRD EIND EINV EUN
SUBJECT: EUROPE FINANCIAL AND ECONOMIC REPORT: FEBRUARY 20TH, 2009

Financial Services Upcoming Issues / Events

Publication of the de Larosiere report:

1.(SBU)On February 25, the High Level Group of Experts tasked by European Commission President Barroso to review the future of financial supervision in the EU will present its recommendations. The de Larosiere report will be followed by Commission's proposals to implement the Group's recommendations, to be unveiled prior to the March 10 ECOFIN.

Guidelines for impaired assets:

2.(SBU) On February 25, the Commission is expected to adopt a set of guidelines to help Member States design programs to buy or insure impaired assets on bank balance sheets.

EC High-Level conference on Private Equity and Hedge Funds (Brussels):
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¶3. (SBU) On February 26 and 27, the Commission will hold a conference to discuss possible future regulation of private equity and hedge funds. At the conference, the Commission will release the results of its recent public consultation on the issue, held in response to reports from the European Parliament calling for increased regulation. Several Member States, such as Germany and France, have recently increased their public calls for regulation.

Financial Services - Recent Events

Credit derivatives dealers commit to clearing via EU-regulated CCPs

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4.(SBU)February 18, the International Swaps and Derivatives Association (ISDA) informed Commissioner McCreevy that nine ISDA member firms (Barclays Capital, Citigroup, Credit Suisse, Deutsche Bank, Goldman Sachs, HSBC, J.P. Morgan, Morgan Stanley and UBS) agreed to commit to use EU-based central clearing for Credit Default Swaps (CDS) on EU-reference entities by end-July 2009. The agreement follows a request made by McCreevy in October 2008. McCreevy welcomed the "commitment from the Industry to agree to the central clearing in Europe for certain CDS which are systemically relevant", adding that he was looking whether other measures might be necessary to ensure that derivatives "are adequately supervised and do not pose unnecessary risks to financial markets".

EP continues discussion on Capital Requirement Directives (CRD)

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¶5. (SBU) On February 11, the European Parliament's ECON Committee discussed proposed amendments to the CRD. The remaining key issues are: retention of securitized products, clearing of credit derivatives, and supervision of financial services. Regarding securitization, a proposal to have different retention requirements for "good" and "bad" securitizations has been met with skepticism by many MEPs, who believe that the distinction will prove unenforceable. Most MEPs appear more comfortable with the blanket 5% retention requirement proposed by the Commission. Regarding clearing of credit derivatives, the Conservatives (EPP-ED) advocate inserting a recital (non binding amendment) mentioning the need for

a CCP, while the Socialists (PES) are pushing for an article imposing higher capital requirements for non-EU-cleared credit derivatives. The Liberals have not yet articulated a position. On supervision, there is agreement that Colleges of Supervisors, though not a satisfactory end-solution, are an appropriate interim step towards more integrated European supervision. The ECON Committee is scheduled to vote on this issue on March 9.

CRAs: EP proposes streamlined supervision and a compromise on extraterritoriality:

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6.(SBU)MEP Jean-Paul Gauzes (French Conservative) report on the Commission's proposal to regulate Credit Rating Agencies (CRAs) advocates: (1) giving primary responsibility for CRA registration and supervision to the Committee of European Securities Regulators (CESR), rather than to national regulators as currently envisaged by the Commission; (2) allowing EU-registered CRAs - including EU subsidiaries of non-EU headquartered CRAs - to endorse ratings prepared by non-EU-registered CRAs for a transitional period of two to three years, during which EU and third country regulators can work out criteria to determine regulatory equivalence. The CRA regulation will be discussed by the ECON Committee on March 9, while the Committee vote is scheduled for March 23.

Solvency II negotiations between EP, EC and Council yield progress:

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¶7. (SBU) According to the EP lead negotiator, MEP Peter Skinner (UK Socialist), progress has been made on resolving difference between the EC, EP, and Member States on Solvency II. The EP and the Commission strongly back the group support provisions of the original proposal, which they say would allow more efficient allocation of capital. While in December the Council had opposed group support, now some Member States appear willing to work out a compromise on group support. The Czech Presidency believes that agreement on a scheme that would allow some aspects of group support

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is possible. Parliament is scheduled to vote March 23-26.

Commission opens review of Investor Compensation Schemes Directive:

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¶8. (SBU) On February 9, the European Commission launched a call for evidence on the application of the Investor Compensation Schemes Directive in Member States. Following recent legal disputes over liability for losses sustained in the Madoff scandal, the Commission is asking stakeholders to provide relevant information to assess how the Directive is being implemented in Member States. This Directive's aim is to protect investors against losses if a firm is unable to repay money, or return assets, held on behalf of their clients. The Commission seeks stakeholders' input by April 8 in order to evaluate: (i) the scope of the Directive in terms of services covered; (ii) the amount of compensation; and (iii) the

funding of compensation schemes. The Commission may, following the exercise, submit a revision of the Directive.
Economics - Upcoming Issues / Events
Assessment of national Stability and Convergence Programs:

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¶9. (SBU) On February 25, the Commission will publish its analysis of the second tranche of national Stability programs (Euro area members) and Convergence programs (other EU members). These documents are macroeconomic and budgetary projections covering the preceding and current years and at least three years ahead. They contain: a medium-term objective (MTO) representing a budgetary position in line with the 3% of GDP threshold or an adjustment path towards the MTO, the underlying economic assumptions, and, for non Eurozone Members, medium-term monetary policy objectives.
Berlin Mini-G-20 (EU G-20 members):

10.(SBU)On February 22, the Leaders of the European G-20 members (Germany, the U.K., France and Italy), EC President Barroso and the current EU President, Czech Prime Minister Topolanek will meet in Berlin to prepare for the April 2 G-20 summit. Leaders aim to lay the foundations for a common European position for the G-20.
Extraordinary meeting of EU Leaders:

¶11. (SBU) On March 1, EU Leaders will meet in Brussels for a working lunch to coordinate national initiatives taken in response to the crisis and address protectionist tendencies. Leaders will discuss the on-going work on how to deal with impaired assets in EU banks, on the basis of guidelines that the Commission will publish on February 25. The extraordinary meeting has been called by the Czech presidency after having been suggested in a joint Sarkozy-Merkel letter to Topolanek and Barroso.
ECB expected to cut and BoE to hold:

12.(SBU)On March 5, the Governing Council of the European Central Bank is expected by market analysts to cut the ECB's main refinancing rate by 50 basis points, to 1.5%. Analysts also believe that the ECB may begin to consider other measures - namely quantitative easing (QE) - to revive the economy without cutting the interest rate to zero. On the same day, the Bank of England Monetary Policy Committee is expected to leave its main interest rate unchanged at 1%, but may start implementing unconventional measures to increase money supply.
Economics - Recent Events
EC initiates "excessive deficit procedures" for six countries.

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¶13. (SBU) The European Commission will open Excessive Deficit Procedures (EDP) for six Member States (MS) that posted deficits over the 3% of GDP threshold in 2008: Ireland, Spain, France, Greece, Latvia and Malta. The EC presented its first tranche of assessments of Stability programs (Ireland, Greece, Spain, France, Germany, the Netherlands, Malta and Finland) and Convergence programs (Hungary, Latvia, Bulgaria, the Czech Republic, Denmark, Estonia, Poland, Sweden and the United Kingdom). While announcing the EDP measures, Commissioner Almunia noted that, "the [Stability and Growth] Pact is not about sanctions" in times of crisis, and that the Commission will take advantage of the flexibility written into the pact when considering its next steps. Almunia recalled that the December European Council affirmed that the SGP remained "the cornerstone of the EU fiscal framework," and noted that "under the present circumstances, preserving the Pact's credibility is key" to maintaining the public and market confidence. The March ECOFIN is expected to endorse the EDP designations, after which the Commission and the Economic and Financial Committee (EFC) will propose policy actions to bring each Member State's deficit below 3%.

Commission reviews French aid to carmakers for breaches of internal market
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¶14. (SBU) The EC Competition authority is assessing the most recent French assistance to its car industry, which has sparked allegations of protectionism from the Czech Republic and threats of retaliation by Slovakia. The Commission has requested information to assess whether the aid contains anti-competitive conditions after President Sarkozy's statement that Peugeot should close a plant in the Czech Republic and bring production home to France.

Grim economic indicators worsen outlook for Europe, as Q4 GDP falls 1.5%
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¶15. (SBU) Q4 GDP declined by 1.5% in both the euro area and the EU (versus -0.2% in Q3). Compared with the same quarter of the previous year, GDP decreased by 1.2% in the euro area and by 1.1% in the EU, after +0.6% and +0.8% respectively in Q3 2007. For 2008, GDP grew by 0.7% in the euro area and by 0.9% in the EU.

¶16. (SBU) In December 2008, the volume of retail trade remained stable month-on-month in both the euro area and the EU. Year-on-year, the retail sales index fell by 1.6% in the euro area and by 0.8% in the EU. In December, the industrial producer price index fell by 1.3% in the euro area and by 1.4% in the EU month-on-month. Industrial production was also down in December by 2.6% in euro area and by 2.3% in the EU, continuing the trend set in November when the index decreased by 2.2% in both zones. Compared to the same month the previous year, the average industrial production index for 2008 fell by 1.7% in the euro area and by 1.6% in the EU27.

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